No. 22,537

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

In the Matter of

HAGGERTY PIPE & SUPPLY COMPANY, a Corporation,

Debtor.

On Appeal From the United States District Court for the Central District of California.

APPELLEE'S BRIEF.

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APPELLEE'S BRIEF.

I.

Applicable Statutory Provisions, and Preliminary Comment Thereon.

The central, "statutory" provision involved in the instant controversy is General Order No. 44 (11 U.S.C. following §53), promulgated by the Supreme Court, and particularly the third sentence thereof, which reads as follows:

> "If without disclosure any attorney acting for a receiver or trustee or debtor in possession shall have represented any interest adverse to the receiver, trustee, creditors or stockholders in any matter upon which he is employed for such receiver, trustee, or debtor in possession, the court may deny the allowance of any fee to such attorney, or the reimbursement of his expenses, or both, and may also deny any allowance to the receiver or trustee if it shall appear that he failed to take diligent inquiry into the connections of said attorney."

This admittedly punitive provision, in substance, codifies within the narrow context defined, the ancient, moral precept that no man can, or should, serve two masters, which is not only a firmly established tenet of our Judeo-Christian civilization, but is similarly a precept of every religious, moral or ethical system worthy of the name. Furthermore, the rule is erected not merely as a bulkwark against the substance of evil, but also against the mere tendency thereto. (*Weil v. Neary*, 278 U.S. 160, 173, 49 S. Ct. 144, 73 L. Ed. 243, 250).

The rule likewise recognizes the inherent difficulty, if not the practical impossibility, of attempting to measure the extent or degree of damage resulting from any given conflict situation, after the fact, and the equally impossible burden which would be placed on the courts if they must attempt to measure the precise harm actually resulting therefrom in each case.

Many of the foregoing observations are clearly recognized in the following language of the Supreme Court in its leading decision entitled *Wood v. City Nat. Bank & Sav. of Chicago,* (1941) 312 U.S. 262, 61 S. Ct. 493, 85 L. Ed. 820, at pp. 268, 269:

> "Furthermore, 'reasonable compensation for services rendered' necessarily implies loyal and disinterested service in the interests of those for whom the claimant purported to act. (Citations omitted). Where a claimant who represented members of the investing public was serving more than one master or was subject to conflicting interests, he should be denied compensation. *It is no answer to say that fraud or unfairness were not shown to have resulted.* (Cf. *Jackson v. Smith,* 254 U.S. 586, 589, 65 L. ed. 418, 424, 41 S. Ct. 200).

The principle enunciated by Chief Justice Taft in a case involving a contract to split fees in violation of bankruptcy rules, is apposite here; 'what is struck at in the refusal to enforce contracts of this kind *is not only actually evil results but their tendency to evil in other cases.*' (Citing, *Weil v. Neary,* supra, 278 U.S. 160).

"Furthermore, the incidence of a practical conflict of interests can seldom be measured with any degree of certainty. *The Bankruptcy Court need not speculate as to whether the result of the conflict was to delay action where speed was essential, to close the record of past transactions where publicity and investigation were needed, to compromise claims by inattention where vigilant assertion was necessary, or otherwise to dilute the undivided loyalty owed to those whom the claimant purported to represent. Where an actual conflict of interests exists, no more need be shown, in this type of case, to support a denial of compensation.*—A fiduciary who represents security holders in a reorganization matter may not perfect his claim to compensation by insisting that, although he had conflicting interests, he served his several masters equally well, or that his primary loyalty was not weakened by the pull of a secondary one. *Only strict adherence to these equitable principles can keep the standard of conduct for fiduciaries 'at a level higher than that trodden by the crowd'.* (See Mr. Justice Cardozo in *In re Meinhard v. Salmon,* 249 N.Y. 458, 464, 164 N.E. 545, 62 A.L.R. 1)" (Emphasis added).

Furtheremore, since General Order 44 deals with a "bedrock" ethical or moral principle, it is not susceptible to the *ad hoc* "exceptions" which may be made, without undue danger, as to mere technical rules predicated on less fundamental considerations. Indeed, it is obvious that the very efficacy of the rule will be largely eroded if it be accorded anything but the "strictest" construction. (See, *e.g.: Weil v. Neary, supra,* 278 U.S. 160; *Matter of Woodruff*, (9th Cir., 1941) 121 F. 2d 152, cert. den. (1941) 314 U.S. 652, 62 S. Ct. 99, 86 L. Ed. 522; *Matter of Eureka Upholstering Co., Inc.*, (2nd Cir.) 48 F. 2d 95; *Albers v. Dickinson*, (8th Cir., 1942) 127 F. 2d 957; *Cf. Stratton v. New*, (2nd Cir.) 51 F. 2d 984, cert. den., 284 U.S. 682, 52 S. Ct. 199, 76 L. Ed. 576, holding that oral statements are not lawful substitutes for the prescribed affidavits).

Although there will later be considered, in depth, Appellant's unsupported assertion that the 1938 addition of subdivision (c) to §44 of the Bankruptcy Act (11 U.S.C. §72(c)), somehow "legalizes" a conflict of interest resulting from an attorney's dual representation of either a receiver or trustee and, at the same time, a general creditor, said subsection should be set forth verbatim, particularly since Appellant's purported quotation thereof, appearing at page 17 of his opening brief herein, conspicuously omits the key word "merely". Said subsection actually reads as follows:

> "c. An attorney shall not be disqualified to act as attorney for the receiver or trustee *merely* by reason of his representation of a general creditor." (Emphasis added).

It is readily apparent that the deliberate inclusion of the word "merely" was to emphasize that Congress had

no intention, in adding the subsection, to abrogate, or alter in any respect whatever, the pre-existing provisions of General Order 44 proscribing conflicts of interest, and the inclusion of such word was clearly calculated to negate precisely the "construction" which Appellant so passionately urges herein. Appellant's significant omission of this key word in his purported quotation of §44(c), without the slightest indication thereof, even if unintentional, constitutes a tacit "Freudian admission" of the key significance of the word, and of the obvious intent of Congress to explicitly negate even the slightest implication that the subsection was meant to legitimize conflicts of interest under any circumstances.

II.

Appellant's Statement of the Case, the Facts, the Alleged Errors, and the "Questions Presented" Are Highly Distorted.

Before considering the numerous distortions of the facts and related matters, as contained in Appellant's opening brief, it is submitted that the Referee's findings of fact are correct and are uniformly supported by substantial evidence, in many cases by Appellant's own testimony. Since the Referee's Findings of Fact and Conclusions of Law encompass eleven (11) typewritten pages [Tr. of Rec., pp. 158-168, incl.] the same are set forth in "Appendix A", hereof. (Parenthetically, the reference to Appellant's client, American Radiator and Standard Sanitary Mfg. Company, as "Amstan", used in the Findings of Fact, will be employed also herein for the sake of brevity).

The following are significant excerpts from the Transcript of June 9, 1966:

1. Pages 3 and 4:

"Mr. Grodberg: Well, I believe that the original petition was filed on May 31, 1963, the petition for an arrangement. Now, at that particular time I represented a number of unsecured creditors. One of these unsecured creditors had a personal guarantee—

The Referee: Which one, so that we can be clear on that?

Mr. Grodberg: Oh, American Radiator and Standard Manufacturing Company.—

Mr. Grodberg: They had a personal guarantee which they had outstanding long since upon the basis of which, as I understand it, they had extended credit—

The Referee: A personal guarantee from?

Mr. Grodberg: Jack Manildi and Vina Gale Manildi, his wife."

2. After testimony by Appellant appearing at pages 12 and 13 of the Transcript of June 9, 1966, relative to a meeting on August 19, 1963, between Appellant, Mr. Bumb, Mr. Laugharn and Mr. Kramer, the Receiver's accountant, concerning the latter's preliminary report indicating possible claims against Santa Monica Plumbing & Supply Company (hereinafter referred to as "Santa Monica") and "suspicions" as to possible claims against Manildi, individually, Appellant testified, in part, as follows, at page 15 of said Transcript:

"Now, immediately after that meeting (of August 19, 1963) either in Mr. Bumb's office or

in Mr. Laugharn's office, when the meeting had adjourned, I had a talk personally with Mr. Bumb *and it was at that time* that I put it to him and he agreed with me that I did not know if it was going to develop that there were any claims in favor of the Receiver against Manildi. *It appeared to me that the Receiver should have independent advice as to the nature and validity of those claims, or whatever they were, against Manildi, and that if it appeared that they were valid claims or that they were meritorious to warrant prosecution that he should have special counsel, both to advise him and to handle that prosecution,* and Mr. Bumb agreed with this, and therefore Mr. Bumb applied subsequently for the employment of Mr. Laugharn as the special counsel of the Receiver.

"Now, I voluntarily, Your Honor, stepped away from a situation where, as soon as it appeared to me there was a potential conflict or the possibility of a conflict between the Receiver and Manildi, you see, I immediately recommended to the Receiver and he followed that, with special counsel being appointed—." (Emphasis added).

The foregoing testimony, among other matters, is relevant in relation to Appellant's belated contention, raised for the first time on appeal, that no conflict, in fact, ever existed! (App. Op. Br. p. 37, *et seq.*) Such testimony is further relevant in respect to Appellant's assertion that there is no evidence that August 19, 1963, was the "first time" Appellant informed the Receiver

of the conflict (App. Br. p. 10.) While Appellant also states at page 10 that:

> ". . . Appellant testified that he had informed the Receiver of this suit and attachment on several occasions prior to the meeting on August 19, 1963 . . ."

as with all his "factual" allegations, there is no reference to the transcript, and we have failed to find any such testimony. [See, also, Tr. of November 14, 1966, and December 2, 1966, p. 38.]

3. In further reference to the existence of a conflict of interest is the following testimony appearing at page 19 of the June 9, 1966, transcript:

> "*The Referee:* Why did you think he (The Receiver) needed special counsel?
>
> *Mr. Grodberg:* To decide whether or not the Receiver had any right in or to these five parcels (of real property owned by the Manildis, and on which Appellant had levied attachments, as had certain other 'guarantee creditors')
>
> *The Referee:* Why couldn't you do that?
>
> *Mr. Grodberg:* Well, I could not do that because how could I advise Mr. Bumb as to this when I represented a creditor who'd be a beneficiary of a trust to which that parcel would be transferred or, pursuant to the new proposal, *I could not advise Mr. Bumb as to whether or not he had any right in and to that because I'd be on both sides of the picture, you see. That is why if was essential that he have the benefit of independent counsel, Mr. Laugharn.*" (Emphasis added.)

Notwithstanding the present denial of a conflict, it would appear from the foregoing that Appellant was well aware of it on June 9, 1966. [See, also, same Tr. p. 21, lines 19-21, incl.]

4. The following further testimony appears in the June 9, 1966, Transcript, page 28, line 14, to page 30, line 2:

> "*The Referee:* You are representing guarantee creditors and I don't expect you to tell me that the trust was no good or the levies were no good or the levies could not have been obviated by bankruptcy, for example.
>
> *Mr. Grodberg:* Well, all I can say is, Your Honor, that as far as I know the levies could not have been obviated by the bankruptcy of Haldeman Pipe & Supply.
>
> *The Referee:* If he were the alter ego?
>
> *Mr. Grodberg:* Now we are getting into the question of alter ego.
>
> *The Referee:* I don't say that he was, I am merely discussing the potential lawsuits in which an attorney for a trustee would normally give advice. It would be hard to get advice, I think, from one who is representing an attaching creditor who had a levy that he wanted to keep.
>
> *Mr. Grodberg:* That is why I did not continue in that.
>
> *The Referee:* All of which comes to the point that there was an adversity of interest. . . .
>
> *Mr. Grodberg:* I honestly don't see it. Every time, are we to assume every time an attorney represents a corporation ipso facto there must be an alter ego possibility?

The Referee: No, but I venture this: every time you represent a trustee of a corporation you had better bear in mind the possibility of subsidiary suits against people such as stockholders, or directors or things of that sort.

Mr. Grodberg: Well, that is certainly, I mean, that is true. But I must say this, Your Honor, that this possibility does exist in every case, and if I may draw an analogy, there always exists in representation of any creditor that the facts may be found subsequently with respect to that particular creditor's claim.

The Referee: Do you know what happens then?

Mr. Grodberg: He cannot represent the trustee in that respect."

5. Also in the June 9, 1966, Transcript, the following appears at page 42, lines 14 to 23, inclusive:

"*The Referee:* Let me put it: Suppose there had been an affidavit presented to me the first time, whenever it was, when you were employed; that affidavit stated: 'I, Mr. Grodberg, wish to be employed as attorney for the trustee but I do represent a creditor who has a claim of some sort against a potential defendant in a suit filed by the trustee', do you think I would have authorized that employment?

Mr. Goldman, (Attorney for the Debtor): If that was all that there was to it, I don't think you would."

In the Transcript of November 14, 1966, and December 2, 1966, the following excerpts are significant:

1. At page 38, although Appellant told the Receiver that one of the creditors he represented held the guarantee of the Manildis, he could *not* remember when he told the Receiver of the attachment of the Manildi's real property. [See, also, p. 39, line 1, to p. 40, line 4.] Further, compare this testimony with the statement at page 10 of Appellant's Brief, that: "Appellant testified that he had informed the receiver of this suit and attachment on several occasions prior to the meeting on August 19, 1963". (As previously noted, without any transcript reference in support thereof).

2. At page 57, the following testimony of Appellant appears:

> "Q. When did you first decide that someone other than yourself should represent Mr. Bumb in connection with any possible lawsuit against Mr. Manildi, personally, or Santa Monica? A. (By Mr. Grodberg) That was on or about August 19th.
>
> Q. What prompted that, sir? A. We had a meeting at either Mr. Laugharn's office or Mr. Bumb's, I don't remember which, and at that time Mr. Kramer was present and —
>
> *The Referee:* Just for the record, Mr. Laugharn represented the creditors committee?
>
> *The Witness:* At that time he was the attorney representing the creditors committee?
>
> *The Referee:* Yes.
>
> *The Witness:* We had a meeting at that time and Mr. Kramer expressed the belief that there was cause for collecting money against Santa Monica Pipe & Supply in favor of Haldeman.

He also raised the question generally that he thought that possibly the matter should be gone into as to whether or not there was a cause of action against Manildi in favor of the debtor by reason of the fact that it appeared that at some time years before, as I recollect it, some of the parcels of real property which were in the debtor's name had at one time, some of them, belonged to Haldeman.

Following that meeting, I discussed with Mr. Bumb the fact that I had represented, that I did represent a guaranteed creditor and on whose behalf I had been participating over a series of some weeks in general discussions and in discussions with creditors, with attorneys representing other guaranteed creditors, directed towards the possibility of making some kind of a settlement by way of establishing a trust, which ultimately was established, not in those terms as they were then being discussed, and I said in view of the fact this had occurred I thought probably, so that there would be no question about the fact whatever advice he obtained should be completely objective and independent, that he should hire Mr. Laugharn as special counsel.

This was after the meeting, Mr. Bumb and I personally discussed this, Mr. Laugharn was not present at this time.

The Referee: Why did you think he needed special counsel?

The Witness: Because I had been engaged in discussions previously about this real property and Mr. Kramer had indicated that he thought that

there was a possiblity that he should look into the question of the true ownership of this property.

The Referee: Is that some of the property you had levied an attachment on?

The Witness: That is correct. When I learned that I said, 'Well, I think you should get independent counsel to advice you on this,' and that was done."

A. Appellant's "Statement of the Case".

1. Appellant states at page 2 of his Brief, that he was employed "as attorney for the Receiver by an Order made and entered on June 6, 1963" (p. 2); however, he neglects to state that he was so employed *generally,* and not merely as Special Counsel, or for some purely limited purpose only;

2. Also at page 2, Appellant states that he was denied any compensation for services rendered as attorney for the Receiver as a result of a "possibility" of a conflict of interest. As the Referee properly found [Find. 21], on May 31, 1963, at which time Appellant prepared the documents authorizing his employment, *there was, in fact, an actual conflict of interest as between the Receiver and Amstan.* Furthermore, on or before June 6, 1963, the date on which the Order authorizing his employment was entered, Appellant "knew, or should have known, that his representation of the Receiver then was, or would be, or, at least, might become, in substantial conflict with his representation of Amstan." [Find. 21.] See also Findings of Fact 22, 23, 24 and 25, and Conclusions of Law 1, 2, 3 and 4.

In short, there was, *in fact,* and *actual* conflict of interest existing even before his employment was au-

thorized on June 6, 1963, and on or before said date Appellant knew, or, certainly should have known, that there was, at least, a distinct possibility that a conflict existed, or would arise, as a result of his dual representation of both Amstan and the Receiver.

B. Appellant's "Statement of Facts".

Before pointing out some of the more glaring, factual distortions contained in Appellant's narration of the alleged facts, it should be noted that there are no transcript references whatever in Appellant's "Statement of Facts", and, further, that all too many of Appellant's "facts" are merely his interpretations thereof, rather than the facts as disclosed in the testimony or documentary evidence. That mere statements of Appellant's interpretations of the facts in lieu of the facts as disclosed by testimony or documentary evidence, with appropriate references to the transcript, is improper, is clear from the following excerpt from a talk given by the Honorable Raymond Peters, now Justice of the Supreme Court of California, in 1951, as set forth in the Los Angeles Daily Journal Report of April 30, 1968, in an article by Theodore A. Horn, of the Western Trial Lawyers' Conference, entitled "Post-Trial Remedies are a Varied Thing", page 11:

> " 'It is important in your detailed statement of facts never to make any statement of a material fact in your brief without a transcript reference. Never misstate the record and be very careful to avoid overstating the record or stating your own conclusions or interpretations of the facts as a fact, just state the facts. Leave your interpretation for argument' ".

While Appellant states at pages 5 and 6 of his Opening Brief that after he received the phone call on June 4, 1963, from Collen (the Chicago attorney representing Amstan) requesting Appellant to immediately sue the Manildis, and attach their real property, he notified the Receiver that he represented a creditor holding a personal guaranty executed by Manildi, nevertheless, as found by the Referee, he significantly failed to advise the Receiver of the contemplated suit and attachment [See the Referee's Find. 11]. The following language from the Referee's Memorandum of May 5, 1967 [Tr. of Rec. p. 142] is pertinent:

> "It is not clear whether at the time of the preparation of the application the applicant knew that the Amstan claim was guaranteed by the Manildis. In the transcript of June 9, 1966, page 4, line 13, Grodberg stated that 'when Mr. Bumb first spoke to me about representing him, which was at the very inception of these proceedings, I told him that I represented a creditor who had a personal guarantee (by the Manildis) . . . who were principals of the debtor—at least Mr. Manildi was, I don't recall whether an officer or not. They also were stockholders of the debtor . . . (p. 5, 1.22) And it was with that interpretation and understanding that the application for my employment was filed . . .'
>
> "On the other hand, at the hearing held December 2, 1966 (p. 23, 1.25 to p. 24, 1.10) the applicant testified that the first knowledge he had of the guarantee was in the morning on June 4, 1963, by reason of a telephone conversation with Collen the attorney who represented the claims forwarded by

Manufacturers Clearing House, for whom the applicant appeared, including Amstan, a copy of which guarantee was forwarded to the applicant by letter dated June 5, 1963, and received June 7, or June 8, 1963 (the exact date not shown). (See Exhibits G 10 and G 10a. When Exhibit G 10 was introduced the second page was not available. Since that time by agreement of counsel the second page has been supplied and marked G 10.).

During the telephone conversation, Collen advised the applicant of the Manildi guarantee and stated he would send a copy to Grodberg, which he did by letter dated June 5, 1963 (Exhibit G 10). They also discussed the matter of filing an action against the Manildis and of attachment of property of the Manildis (Exhibit G 10).

The applicant could not recall when he told the receiver about any levy of attachment (12-2-66 tr., p. 38, l.8, to p. 40, l.4). On June 4 (after he talked to Collen) the applicant told the receiver about the guarantee, Leonard A. Goldman, attorney for the debtor being present (Goldman had been attorney for Manildi for about four to six weeks, beginning May 29 or May 31, 1963 (12-2-66 tr., p. 8, l.17 to 23). At that time the applicant did not tell the receiver about the proposed attachment."

While Appellant notes at page 6 of his Brief that Haldeman and Santa Monica were "related corporations", he omits to state that both were wholly owned and controlled by the Manildis. [Find. 3.] Also, at page 6, Appellant states that rumors arose "subsequently and

during the course of the Receiver's administration" that "other claims against Santa Monica might exist in favor of Haldeman"; however, see, *infra,* the excerpts from the transcript of June 9, 1966, page 10, line 18, to page 11, line 2; the transcript of November 14, 1966, and December 2, 1966, page 45, line 14, to page 46, line 10, which strongly support the inference that such "rumors" were known to Appellant even *before* he drafted the Application for his employment.

At page 8 of his Brief, Appellant asserts that the Court's approval of the Plan of Arrangement "had the effect of relinquishing any rights the Receiver may have had in the real property constituting the corpus of the Leland Trust". However, in fact, there was a distinct possibility that some or even all of the real property would revert back to Manildi. See Appellant's own testimony, Transcript of December 2, 1966, pages 8 and 9, including the following portions thereof:

1. At page 8, lines 13 to 25, inclusive:

> "A. That would depend. If Mr. Manildi had the option of paying seventy-five cents on the dollar of the 'Guaranteed Creditors' claims before a year was up, under the terms of the Trust—*then the real property would be returned to him —or, under the terms of the Trust, if some parcels could be sold within a year's period, by consent of all concerned, including the Receiver, if that were desired, then, if there was not enough from such sales to make up seventy-five cents on the dollar, it was anticipated that he would be given credit* for the dividend to make up the additional amount. So that would depend on what facts evolved as to who would get the dividend." (Emphasis added.)

2. At page 9, line 13, to page 10, line 3, inclusive:

"A. I would suppose so—although—no—not really—because—you see, this was to the benefit of Mr. Manildi—these dividends; *in other words, he might not have to apply parts of the property to the Trust*—suppose he were to sell off two of them, one of the small ones—something like that—and raise enough to pay sixty per cent and then, as was anticipated, there would be within the year a dividend of fifteen per cent—we had projected a dividend of twenty-five per cent or more—then that fifteen per cent would be credited toward the seventy-five per cent, *and the property would be returned.*

Q. Who would get the balance of the dividend on the claims? Would it go back to Mr. Manildi?

A. In effect it would because the creditors had settled for seventy-five cents on the dollar and he had been subrogated to whatever rights they had." (Emphasis added.)

Also relevant is the testimony of Hubert F. Laugharn, Special Counsel for the Receiver, appearing in the Transcript of June 9, 1966, page 35, line 16, to page 39, line 11, from which it is apparent that the critical time deadline with which said Special Counsel was faced when employed by the Receiver after the latter became aware of Appellant's conflict of interest, rendered it virtually impossible to effectively determine, within the ten (10) days allotted [p. 37, lines 20-22, incl.] whether steps could be taken to avoid the attachment liens on the Manildis' real property, as by the filing of Involuntary Petitions in Bankruptcy against them, and, at the same time, prepare and file the complex Complaint in

the Superior Court versus Santa Monica and the Manildis. [See, particularly, p. 38, lines 4-20, incl.; see, also, line 20, recognizing the possibility that a "residue" of the real property might revert back to the Manildis.]

Appellant's recitation of the facts: (1) that the Receiver's lawsuit against Santa Monica and the Manildis was eventually settled; and (2) that the $32,000.00 paid to the Receiver by way of settlement, came solely from Santa Monica, are wholly irrelevant. Even where a claim, which gives rise to a conflict, is ultimately adjudicated to be wholly unmeritorious, such fact does not alter the fact that the conflict existed, nor does it preclude disallowance of the attorney's fee under General Order 44. (See, *e.g.: Woods v. City Nat. Bank & Sav. of Chicago, supra,* 312 U.S. 262; *In re Woodruff, supra,* 21 F. 2d 152.)

It also should be noted that conspiciously absent from Appellant's narration of the alleged facts, is any reference whatever to the facts set forth in the Referee's Finding of Fact 15, viz.: (1) that Appellant *never* directly advised the Referee that he was representing an adverse interest; and (2) that he *never* made, or even suggested, any modification of his affidavit, or the Receiver's Application.

Finally, it is again noted that Appellant cites no source for his statement (at p. 10 of his Brief) that he had "informed the receiver of this suit and attachment on several occasions prior to the meeting on August 19, 1963 . . .". and we are aware of no evidence thereof. To the contrary, see Appellant's testimony of June 9, 1966, *supra,* appearing at page 15 of the Transcript of said date.

C. Appellant's "Summary of Argument".

Appellant's said "Summary" assumes certain facts not in evidence, ignores other facts in evidence, begs certain issues and, generally, presents distortions of both fact and law. In the interests of brevity, only the more glaring examples will be catalogued as follows:

1. Appellant was disqualified from representing the Receiver not merely because he also represented a creditor whose claim was guaranteed by the debtor's principals, as Appellant infers at page 12, paragraph 1, but because there, in fact, existed a conflict of interest *ab initio,* which Appellant knew, or should have known, *prior* to entry of the Order authorizing his employment.

2. Appellant's assumption that the facts giving rise to the conflict of interest were "unknown" is not only unjustified, but it ignores credible evidence which strongly supports the inference drawn by the Referee, that prior to entry of the Order authorizing his employment, Appellant knew, or should have known, (1) that there were possible causes of action in favor of the Receiver against Santa Monica and the Manildis (the principals of both Santa Monica and the debtor); and (2) that his contemplated suit against the Manildis, and attachment of their real property, necessarily conflicted with his duty to the Receiver.

3. Clearly the facts set forth above should have alerted any attorney to the conflict of interest which actually existed, and, obviously, had they been set forth in either Appellant's Affidavit, or the Receiver's Application, it is extremely dubious that the Referee would have authorized Appellant's employment. Again, Appellant's assumption that the facts, pointing to conflict,

were "unknown", ignores credible, if not compelling, evidence to the contrary.

4. Appellant's paragraph 1, at page 13 of his Brief, while literally correct, borders upon absurdity since §44(c) obviously does not even purport to "disqualify" an attorney from representing fiduciaries appointed under the Bankruptcy Act, but merely removes the former *ipso facto* disqualification where the attorney also represented general creditors. We hasten to add that the mere removal of the previous automatic disqualification, was *not* intended to sanction or permit a conflict of interest arising from an attorney's dual representation of a receiver or trustee and, at the same time, a general creditor, as Appellant appears to suggest.

5. Appellant's paragraph 2, page 13 of his Brief, merely "begs the issue", assumes that Appellant had no knowledge, or reason to know, of the conflict prior to his employment, and ignores credible evidence to the contrary. These observations apply equally to his paragraph 3.

6. Appellant's paragraph 4 (p. 14) again ignores credible evidence that he knew, or should have known, before entry of the Order authorizing his employment, that a conflict existed, and blithely assumes the contrary. As previously noted, the facts that the Receiver's lawsuit was ultimately settled, and that the funds paid thereunder were funds of Santa Monica is wholly immaterial as a matter of law.

7. While we propose to consider at a later point, Appellant's new, and startling, assertion that he did not represent an adverse interest, it should be noted at this point that this new "argument" is contradicted at page

22 of his own Brief! Thus, at said page appears the following:

> "Had the evidence shown that appellant actually knew at the time he prepared his affidavit, or even at the time that the order authorizing his employment was approved by the court, that the receiver had a cause of action to recover on behalf of the corporate debtor, assets which were in the possession of the guarantors, *that fact would disqualify appellant from acting as attorney for both the receiver and such guaranteed creditor.*" (Emphasis added.)

While we submit that credible evidence fully supports the Referee's finding that Appellant knew, or should have known, the relevant facts respecting the probable conflict *before* he was employed by the Receiver, the conflict, in fact, existed regardless of knowledge, and Appellant's apparent assumption that no conflict exists, unless and until it is known, is a gross *non sequitur*. That is, Appellant appears to suggest that a conflict of interest only exists where it is actually known by the parties. Obviously, the existence of a conflict and the knowledge thereof are separate and distinct, and an existing conflict is no less real merely because it may be unknown at a particular point in time. It is, at least, theoretically possible that a particular conflict might never be perceived; however, such abstract philosophizing is unnecessary here, since it is quite apparent from Appellant's previously quoted testimony that, at least, as of June 9, 1966, he was aware of the conflict, regardless of when he acquired such awareness.

D. Appellant's "Questions Presented".

Appellant's "questions" are "loaded", distorted, assume facts not in evidence, ignore facts in evidence, and often "beg the issue."

1. The answer to question No. 1, page 15, obviously is not *per se,* but such an attorney should bear in mind the possibilities of causes of action in favor of the estate and against the principal; hence the facts respecting his representation of such "guaranteed creditor" should be set forth in the attorney's affidavit. Furthermore, the question framed, wholly ignores the existence of credible evidence which fully supports the Referee's finding that Appellant knew, or should have known, that a conflict existed *before* he was employed by the Receiver.

2. The answer to question No. 2, page 15, is an unequivocal "yes", and especially so where, contrary to Appellant's unfounded assumption, the attorney knows, or should know, the facts giving rise to the conflict even prior to his employment.

3. Appellant's multifaceted question No. 3 (a through f) is so replete with unfounded assumptions, so studiously ignores credible evidence contrary thereto, and so clearly begs the real issues, that it should be candidly labelled as "argument", rather than a reasonably fair and honest attempt to state the issue, or issues; this also disposes of question No. 4, which is wholly predicated upon the unfounded assumptions of question No. 3.

III.

The Finding With Respect to Appellant's Knowledge of the Probable Conflict of Interest, Is Supported by Substantial, if Not Compelling, Evidence.

The evidence clearly supports, if it does not virtually compel, the inference, clearly and properly drawn by the Referee, that prior to entry of the order authorizing his employment as attorney for the Receiver, which occurred on June 6, 1963, Appellant knew, or certainly should have known, particularly in view of his experience, that there was a real and probable conflict of interest resulting from his dual representation of Amstan and the Receiver, and stemming from (1) his duty to Amstan to acquire and preserve a lien in its favor on Manildi's real property, and (2) his duty to the Receiver to investigate and prosecute an apparent cause of action versus Manildi, based upon the latter's diversion of the debtor's assets to Santa Monica Pipe & Supply Co., and, concomitantly, to aggressively pursue any assets of Manildi as a source of satisfaction of any judgment that might be obtained against him. This evidence is as follows:

1. The Receiver's Application to Employ Appellant as Counsel [Tr. of Rec. pp. 10-12, incl.], which was prepared by Appellant, sets forth, *inter alia,* the following reasons or purposes for Appellant's employment:

> "E. To examine witnesses under the provisions of Section 21-A (sic) of the Bankruptcy Act as the same may be found necessary and appropriate to ascertain facts *and to determine if legal action should be taken to preserve assets of this es-*

tate including by way of specification and not by way of limitation the relationships between the above-entitled debtor and subsidiary or connected corporations with specific reference to business transactions between them." (Emphasis added.)

2. The full significance of the italicized language contained in the foregoing quotation, emerges more clearly in the light of certain testimony of Appellant, to be set forth hereinbelow, and also in conjunction with the further facts, set forth in paragraph 3 of the Referee's Findings of Fact, pages 2, 3 [Tr. of Rec. p. 159]:

"3. That Jack Manildi was president, a director, and, with his wife, the sole stockholder of the debtor, and he was also president, a director, and with his wife, the sole stockholder of a second corporation, *Santa Monica Plumbing & Supply Company*. That there had been extensive business and credit transactions between the debtor and the last-named corporation prior to the filing of the debtor's petition herein."

As appears in the Transcript of June 9, 1966, page 10, line 18, to page 11, line 2, Appellant testified as follows:

"Now, it had been, I suppose you might say, generally scuttlebut-type of knowledge *that it was well known that Santa Monica had some kind of connection*—I won't try to define the legality of their arrangement—*that Santa Monica and Haldeman were interrelated in some way*. As a result, I prepared an application for the appointment of the accountant, Mr. Kramer, to investigate on behalf of Mr. Bumb the relationship between San-

ta Monica Pipe and Haldeman *because the rumors had it that Santa Monica was being used, to use plain language, to milk Haldeman."* (Emphasis added.)

Further, in the combined Transcript of November 14, 1966, and December 2, 1966, Appellant further testified as follows on December 2, 1966, page 45, line 14, to page 46, line 10:

"*Mr. Potts:* I believe I can clarify that again.

Q. Isn't it true, Mr. Grodberg, you first learned of the Manildi situation on June 4th when you had a telephone conversation with Mr. Collen who then advised you of the guarantee? A. No, that is not so. On the day that I filed in order to prepare the application for appointment of attorney, the day Mr. Goldman and I came down here [i.e., May 31, 1963. See same transcript, same page, lines 6 to 8, inclusive], then we discussed, as we discussed in chambers with Your Honor, a general picture of the case, that was it. I asked Mr. Goldman to relate to me, to summarize to me what proposals, if any, had been made, so I would get an over-all picture of what the situation was. *Undoubtedly he mentioned to me that there was a person named Jack Manildi who was a principal* [of the] *debtor, I am sure that must have occurred* although I don't remember any specific discussion about it. *But I was made aware Haldeman was a substantial corporation, that Manildi was its president,* that he had a son in there who was apparently active, that there were a number of other persons also active in the corporation. *He gave me some ideas which*

I incorporated, as a matter of fact, in the application for appointment as the attorney for the Receiver." (Emphasis added.)

(See subdivision E. of the Application to Employ Appellant as attorney for the Receiver, *supra*).

In the aforesaid, combined Transcript of November 14, 1966, and December 2, 1966, Appellant further testified as follows, page 46, line 13, to page 48, line 11, inclusive:

"*The Referee:* When did you learn there were other corporations with which Haldeman had had past dealings?

The Witness: Mr. Goldman.

The Referee: And what was said in that respect?

The Witness: Well, he said there was an account receivable in favor of Haldeman against Santa Monica Pipe, and, as I understood it, there was a proposal to settle that for $50,000 for which the Receiver collected $32,000. I don't know the details of that, but that was my understanding of it.

The Referee: This was back when?

The Witness: May of 1963. I may be way off on that, but that shows the extent of my actual knowledge of the details of it.

The Referee: All right, you may proceed.

Mr. Potts: Thank you, Your Honor.

Q. Now, Mr. Grodberg, do you have a copy of the application for your employment in your file? A. I have it in another file.

The Referee: We will take a recess now for ten minutes, the reporter and I are getting tired."

[Whereupon, a recess was taken after which, all parties being present as heretofore noted, the proceedings were further resumed as follows]:

"Q. [By Mr. Potts] Do you have it, Mr. Grodberg? A. I do.

Q. I would like to direct your attention to Paragraph E., I wish you would read that over and then I would like to ask you about it, if I may. A. Yes.

Q. Now what do you mean when you are referring to 'and not by way of limitations the relationships between the above-entitled debtor and subsidiary or connected corporations', and so on, what had you reference to? A. I had reference to the fact it was my understanding, from my conversation with Mr. Collen, that there was an account receivable in favor of Haldeman Pipe & Supply Company and against Santa Monica Plumbing Supply Company, which was a related corporation as I understood it.

Q. Why did you use the plural 'or connected corporations', if it was only Santa Monica that you had in mind? Was that an oversight or a typographical error? A. It had no special significance.

Q. *You recall last time, on June 9th, you testified there was, to use your term, scuttlebut knowledge to the effect there was an interrelationship between Santa Monica and Haldeman. Am I correct, Mr. Grodberg?* A. *Yes.*

Q. *And that, again, was the information which you had derived from Mr. Goldman? A. Yes.*" (Emphasis added.)

Clearly, all of the foregoing testimony justifies, if it does not, in fact, virtually compel, the inference, which the Referee obviously, and properly, drew, viz.: that *before* even drafting for the Receiver's signature, the application for Appellant's employment, Appellant *must have known* that there was a distinct possibility, if not probability, that Manildi, as the controlling principal of both corporations, had diverted assets from the debtor to Santa Monica Plumbing & Supply Company, and, as a necessary corollary, that a cause, or causes, of action existed in favor of the Receiver against Manildi. Since Appellant was requested by Collen on June 4, 1963, to sue on Manildi's guaranty, and attach the latter's real property, the likelihood and dimensions of the conflict of interest should have been apparent to any attorney of even modest experience, and certainly to one with Appellant's previous bankruptcy practice and experience.

That the Referee did, in fact, find from Appellant's own, foregoing testimony that the contemplated 21(a) examinations, as referred to in subdivision "E" of the Receiver's Application for Appellant's employment, *supra*, which Appellant himself prepared, included an examination of Manildi, is clear from the following language contained in the Referee's Memorandum of May 5, 1967, page 12 [Tr. of Rec. p. 150, lines 18-25, incl.]:

> "Grodberg contends that item (E) relating to examination of witnesses under Section 21a was intended to apply to a $50,000 account receivable assertedly owing by Santa Monica Plumbing. *It must be held that the contemplated examinations would include an examination of Manildi as the*

representative of the debtor and that such examinations properly conducted would inevitably lead to the causes of action in Case No. 825741 (by the Receiver versus Manildi, et al)". (Emphasis added.)

In short, the Referee drew the obvious inference that at the time Appellant drafted the Receiver's Application for Appellant's employment, on May 31, 1963, Appellant contemplated, *inter alia,* examining Manildi relative to possible diversions of the debtors's assets to Santa Monica Plumbing and Supply Company, and hence Appellant must have then known that there existed, at least, the possibility of a particularly acute conflict of interest arising from his representation of Amstan, and his impending representation of the Receiver.

Since Appellant received instructions in the course of his telephone conversation with Collen (the Chicago attorney for Amstan) on June 4, 1963, to immediately sue and attach the Manildi's real property, it appears inescapable that he then *must have known* that there existed a very real and acute conflict of interest arising from his dual representation of Amstan, and his impending representation of the Receiver. This was two (2) days *prior* to entry of the Order authorizing his employment as attorney for the Receiver. Certainly the evidence more than supports the inference drawn by the Referee.

It is, of course, elementary, that the Referee's findings of fact *must* be accepted on both review and appeal, unless they are "clearly erroneous". (Rule 52(a), Fed. Rules of Civ. Procedure; Bankruptcy General Order 47; *Earhart v. Callan,* (9th Cir., 1955) 221 F. 2d

160, cert. den., 350 U.S. 829, 76 S. Ct. 59, 100 L. Ed. 740; *Gold v. Gerson,* (9th Cir., 1955) 225 F. 2d 859; *Lines v. Falstaff Brewing Co.,* (9th Cir., 1956) 233 F. 2d 927, cert. den., 352 U.S. 893, 77 S. Ct. 129, 1 L. Ed. 2d 88; *Hudson v. Wylie,* (9th Cir., 1957) 242 F. 2d 435, cert. den., 355 U.S. 828, 78 S. Ct. 39, 2 L. Ed. 2d 1; *Hoppe v. Rittenhouse,* (9th Cir., 1960) 279 F. 2d 3; *Jue v. Bass,* (9th Cir., 1962) 299 F. 2d 374; *Englebrecht v. Bowen,* (9th Cir., 1962) 300 F. 2d 891).

It further appears settled now that the "clearly erroneous" test applies even to factual inferences drawn from so-called "undisputed facts" (*United States v. Gypsum Co.,* (1948) 333 U.S. 364, 68 S. Ct. 525, 541, 92 L. Ed. 746; *C.I.R. v. Duberstein,* (1960) 363 U.S. 278, 291, 80 S. Ct. 1190, 1200, 4 L. Ed. 2d 1218.) While there were decisions in the Ninth Circuit, and certain other circuits as well, appearing to reflect a contrary view, the Ninth Circuit, at least, has now clearly accepted the foregoing rule enunciated by the Supreme Court, as a result of its decision in *Lundgren v. Freeman,* (9th Cir., 1962) 307 F. 2d 104, noted (1963), in 41 Tex. L. Rev. 935. In the 1967 Pocket Part to Barron and Holtzoff, Federal Practice and Procedure, Vol. 2B, the following appears in §1132, at pages 160, 161 thereof:

> "§ 1132.—Inferences.
>
> In a major opinion, the Ninth Circuit, recognizing the differences of view in its earlier decisions, has accepted the understanding of Rule 52 here urged. The case is *Lundgren v. Freeman* (cited in footnote No. 17.13, P. 161), in which Judge Duniway spoke for the court. Attributing to the late Judge Jerome N. Frank the view that the

appellate court is free to find the facts for itself where the evidence was written, and to Judge Charles E. Clark the view that the 'clearly erroneous' test applies regardless of the nature of the evidence, the court said: 'It seems to us that the Clark view is favored by history. Rule 52(a) incorporates the type of review that previously was had in equity cases . . . Nothing in the history of review of equity cases or of law cases tried without a jury suggests that the appellate court ever decides issues of fact in the first instance, even where it considers itself as fully qualified as the trial judge to do so. Rule 52(a) should be contrued to encourage appeals that are based on a conviction that the trial court's decision has been unjust; it should not be construed to encourage appeals that are based on the hope that the appellate court will second-guess the trial court. Rule 52(a) explicitely clearly applies where the trial court has not had an opportunity to judge the credibility of witnesses.' This forthright and scholarly opinion, if heeded elsewhere, should end any doubt as to the scope of review of findings of fact."

It follows, *a fortiori* that the Referee's factual inferences drawn from *disputed facts* must be accepted unless "clearly erroneous". Here, the evidence is so clear, and the inference so compelling, that only the most naive and unsophisticated trier of fact could have failed to perceive, and draw, the obvious and compelling inference which forms the basis of the Referee's Finding of Fact 21 herein, viz.:

"That on or before June 6, 1963, the date of entry of the Order authorizing his employment as

attorney for the receiver, Grodberg actually knew, or should have known, that his representation of the receiver then was, or would be, or, at least, might become, in substantial conflict with his representation of Amstan." [Tr. of Rec. p. 187.]

It is submitted that the Referee's alternative finding that Appellant "should have known" of the probable conflict of interest, is less the result of any real doubt as to Appellant's knowledge thereof, than it is a manifestation of an understandable reluctance to state categorically, and with unseemly omniscience, the extent or state of another's "knowledge" as of a particular point in time, irrespective of the persuasive evidence thereof. It is further submitted that: (1) it was within the Referee's province, as trier of fact, to arrive at this finding, and (2) that the evidence supporting the same is sufficiently substantial, if not compelling, that it cannot be viewed as erroneous in any respect, much less "clearly erroneous."

IV.

The Principles of Law Governing the Instant Appeal Are Contained Solely in General Order 44; Furthermore, Section 44(c) of the Bankruptcy Act Was Not Intended to, and Does Not, Affect in Any Manner, the Provisions of Said General Order.

We have heretofore set forth verbatim the third sentence of General Order 44, which is the operative provision governing conflicts of interest. Said General Order was promulgated by the United States Supreme Court on April 13, 1925, under and pursuant to the authority set forth in former §30 of the Bankruptcy Act (11 U.S.C. §53), which said section was repealed on

October 3, 1964, in connection with which, the rule making power was transferred to 28 U.S.C. §2075, subject, however, to the proviso that such repeal did *not* operate to invalidate or repeal prior rules, forms, or orders prescribed by the Supreme Court under the authority of §30. The final sentence of the new §2075 (28 U.S.C.) reads as follows:

> "All laws in conflict with such rules shall be of no further force or effect after such rules have taken effect."

General Order 44 was amended in 1933, 1936, and finally in 1939, *after* the enactment of the Chandler Act of 1938. The third sentence, which governs the instant controversy, was added in 1933, and has been continued with minor changes, not material to this controversy, ever since.

Contrary to Appellant's view that the General Orders are merely ancillary, procedural rules to be given but little weight, even some of the decisions cited by Appellant clearly recognize the substantive importance of the General Orders. Thus, in *Matter of Hodges,* (D.C., Conn., 1933) 4 F. Supp. 804, affirmed, *sub nom., United Wall Papers Factory Inc. v. Hodges,* (2nd Cir., 1934) 70 F. 2d 243, cited at p. 18 of Appellant's brief, the Court expressly stated the following at p. 806:

> "It has, of course, long been established that general orders of the Supreme Court under authority of the Bankruptcy Act *are to be regarded as the statutes, In re Brecher,* 4 F. 2d 1001, 1002," (Emphasis Added).

(See, also, *Matter of L. M. Axle Co.,* (6th Cir., 1925) 8 F. 2d 581, at p. 582).

Appellant's novel contention, for which absolutely no authority is cited, that the 1938 amendment adding subdivision (c) to §44 of the Bankruptcy Act (11 U.S.C., §72(c)), somehow modifies the third sentence of General Order 44, has the support of neither reason for authority, and would certainly come as a surprise to the Supreme Court which revised General Order 44 in 1939, *after* the 1938 addition of subdivision (c) to §44, for the purpose, as stated in the prefatory note to the General Orders in bankruptcy, as follows:

> "To conform to the many revisions of the act effected by the Chandler Act of 1938."

It would violate all established canons of statutory construction, not to mention the most elementary principles of logic, to construe §44(c) as a *sub silentio* repeal of, or amendment to, *any* portion of General Order 44. It should be noted that the decision by the Court of Appeals for the Ninth Circuit in the *Woodruff* case, *supra,* 121 F. 2d 152, was handed down *after* the 1938 addition of subdivision (c) to §44, and said decision quite obviously construes General Order 44 as strictly as any of the pre-1938 decisions.

The purpose, and the *sole* purpose, of the addition of subdivision (c) to §44 of the Bankruptcy Act was to remove the pre-existing fiat under which an attorney for a creditor was absolutely precluded from representing either a Receiver or Trustee in bankruptcy. That Congress intended nothing more is clearly evident from its use of the word "merely", which Appellant so conveniently omitted from its purported quotation of §44(c), at p. 17 of his brief. As previously stated, Congress expressly utilized the word "merely" to emphasize that an attorney representing a general creditor

was not to be disqualified from representing, a Receiver or Trustee in bankruptcy, *merely* by reason of his representation of such general creditor, and to further emphasize that the statute is not to be construed as accomplishing more than the mere removal of the previous automatic disqualification.

Since the addition of subdivision (c) to §44 of the Bankruptcy Act was not remotely intended by Congress to legitimize a conflict of interest, contrary to the clear provisions of General Order 44, the substantive result of the addition of said subsection (c) is simply this: although an attorney for a general creditor is now free to act as attorney for either a Receiver or Trustee in bankruptcy, the old *ipso facto* qualification having been removed, nevertheless, if he elects to do so, such attorney *assumes the inherent risk of possible disallowance of his fee, should it develop that a conflict of interest, in fact, existed, irrespective of whether the same was known or unknown, at the time of his employment.*

Of course, such "inherent risk" is all the greater, where, as here, the creditor whom the Receiver or Trustee's attorney also represents has a guarantee by a principal of a corporate bankrupt or debtor, since there is *always* the definite possibility that the Receiver or Trustee may have a cause of action against the principal for a bankruptcy preference, director's preference, fraudulent transfer, diversion of assets, etc., and the more "experienced" the attorney, the greater should be his awareness of this fact.

The foregoing merely underscores the importance in any such "high risk situation" of making a thorough and meticulous disclosure to the Court of all possible

conflicts of interest, and, specifically, all material facts bearing upon the attorney's relationship to, and representation of, a general creditor, or creditors. It is where, as here, the attorney fails to make the requisite disclosure that he is, to quote from Appellant's brief, playing "Russian Roulette" with respect to his fees, and the simple and obvious way to obviate the risks incident to such "Slavic speculation", is simply to disclose to the Court all of the attorney's relevant connections with the general creditor or creditors involved.

Incidentally, Appellant's interpretation of *In re Rury,* (9th Cir., 1924) 2 F. 2d 330 (p. 19 of Appellant's brief) as being contrary to the pre-1938 rule precluding attorneys for general creditors from representing bankruptcy Receivers or Trustees, is, at least, questionable. All that the Court there held was that "there is no *necessary* conflict of interest between a creditor and a Trustee in bankruptcy and, if the two see fit to join forces and employ the same attorney in an effort to recover assets, *the adverse party or a stranger will not be heard to complain.*" (Emphasis Added). See, also, 2 Collier on Bankruptcy, (14th Ed.) ¶14.22, p. 1680. See, also, p. 1681, Footnote 5, setting forth, *inter alia,* the following:

> "But an attorney for a creditor whose claim is under attack should not be chosen as attorney for the Trustee whose duty it is to make the attack. See *Pepper v. Litton,* (1939) 308 U.S. 295, 41 Am. B.R. (N.S.) 279, 40 S. Ct. See, also, *Matter of Woodruff,* (C.A. 9th, 1941) 46 Am. Br. (N.S.) 567, 121 F. 2d. 152, cert. den., (1941) 314 U.S. 652, 62 S. Ct. 99, 86 L. Ed. 522, where it was held that attorneys for a creditor whose claim

was disputed by the Trustee should not be appointed attorneys for what was in effect an ancillary Receiver."

In his zeal to "construe" the 1938 addition of subdivision (c) to §44 so as to support his position, Appellant appears to intimate that Congress thereby intended to "legalize" a conflict of interest arising from an attorney's representation of both a general creditor, as well as a bankruptcy Receiver or Trustee. Not only is there nothing in either §44(c) or in its legislative history to remotely suggest any such drastic intention, but Congress' advised inclusion of the word "merely" expressly negates any such drastic intent. Furthermore, it is a well established rule of statutory construction "that nothing may be read into a statute which is not within the manifest intention of the legislature as gathered from the act itself." (50 Am. Jur. Statutes, §229, p. 214; *Yu Cong Eng v. Trinidad,* 271 U.S. 500, 70 L. Ed. 1059, 46 S. Ct. 619; *Howard v. Illinois Cent. Ry. Co.*, 207 U.S. 463, 52 L. Ed. 297, 28 S. Ct. 141). The following, additional rule of statutory construction, set forth in 50 Am. Jur. Statutes, §229, p. 281, is clearly applicable:

> "It has even been presumed that the legislature intended that the statute should be construed in the light of settled and uniform policy of the law relating to the subject matter, and that there is no intention to depart from any established policy of the law. *Accordingly, a purpose to effect a radical departure from a firmly established policy will not be implied but must be expressed in clear and unequivocal language,* and such policy is not to be regarded as abandoned further than the terms

of the statute and objects of the legislature unmistakably require. Citing: inter alia, *Murdock v. Memphis,* 20 Wall, (U.S.) 590, 22 L. Ed. 429." (Emphasis added).

See, in accord, 45 Cal. Jur. 2d Statutes, §100, p. 614.

Applying the foreoing rule to the instant case, it is submitted: (1) that it is the strong, settled, and uniform policy of the law to prohibit conflicts of interest; (2) that any legislative enactment, departing from such fundamental policy, could not be characterized other than as a "radical departure from a firmly established policy". Not only is there nothing in §44(c) in the nature of "clear and unequivocal language", indicating an intention to depart from the long settled and uniform policy of proscribing conflicts of interest, but, as previously noted, the inclusion of the word "merely" explicitly negates any intention of so doing. In fact, it is all but inconceivable that Congress would "inferentially" strike down the settled rule, based upon a centuries-old moral doctrine, which prohibits conflicts of interest. It is further submitted that the foregoing observations are wholly consonant with the further rule of statutory construction, viz: "The courts may not, by implication, read into a statute that which is not intended to be there, or make an implication which the language of the statute does not warrant". (50 Am. Jur. Statutes, §242, p. 238; *United States v. Merriam,* 263 U.S. 179, 44 S. Ct. 69, 68 L. Ed. 240, 29 A.L.R. 1547).

While the decision in the *Matter of Cal-Neva Lodge, Inc.,* (D.C., Nev.), set forth in "Appendix A" of Appellant's brief, is readily distinguishable from the facts

of the instant case, nevertheless the unfortunate dictum employed therein, as quoted at page 21 of Appellant's brief, conflicts with all rules of statutory construction, not to mention, common sense, if by said language the Honorable District Court is "construing" §44(c) as "legalizing" a conflict of interest. Furthermore, these rules of statutory construction, all of which are, of course, based upon logic, clearly apply, *a fortiori*, as to General Order 44, dealing as it does with fundamental principles of morals and ethics, as distinguished from mere technical rules of law. Only the clearest and most unequivocal language, precluding any other logical interpretation, could reasonably lead to the conclusion that §44(c) was intended to modify General Order 44, and authorize a conflict of interest, as an "exception" to said General Rule, and the ethical concept on which it is predicated. Again, no such "clear and unequivocal language" remotely evincing such intent, is to be found in §44(c).

V.

The Woodruff Case Is Controlling, and the Facts of the Instant Case Are Manifestly Stronger in Support of Disallowance Than the Facts of Woodruff.

Unfortunately, Appellant's "analysis" of the *Woodruff* case is equally as distorted as his recitation of the facts of the instant case.

The facts of the *Woodruff* case, insofar as they relate to General Order No. 44, may be briefly summarized as follows: On July 5, 1939, Woodruff filed a Voluntary Petition in Bankruptcy in the District Court for the Eastern District of Oklahoma, and was, on the

same day, adjudicated a bankrupt. On July 13, 1939, one M. E. Heiser filed an Involuntary Petition against Woodruff in the District Court of the United States for the Southern District of California, and, on the same day, the California court appointed one E. A. Lynch as Receiver. Thereafter, on July 20, 1939, at the first meeting of Woodruff's creditors, the Oklahoma court appointed the appellant, one P. M. Jackson, as Trustee in Bankruptcy, and, thereafter, on July 27, 1939, the California court, upon the verified petition of the Receiver, authorized the employment of Leonard J. Meyberg and Rupert B. Turnbull, as attorneys for the Receiver. Subsequently, on October 16, 1939, an Order was entered to the effect that the California case be transferred to the Oklahoma court for the greatest convenience to the parties in interest. The Oklahoma Trustee objected to the fee allowances of both the Receiver and his attorneys. With respect to the attorneys, the Oklahoma Trustee asserted that their fees should be disallowed under General Order No. 44, for non-disclosure of a conflict of interest.

After quoting General Order No. 44 verbatim, the majority opinion in *Woodward* held as follows:

> "In this case, the receiver's attorneys (Turnbull and Meyberg) were appointed upon a verified petition of the receiver which, though not signed by Turnbull and Meyberg, was prepared by them. At that time and at all times here pertinent, Turnbull and Meyberg were attorneys for Heiser, the petitioning creditor, whose claim against the estate, amounting to $278,631.71, was disputed by appellant as trustee. Thus, at the time of procuring their appointment as attorneys for the receiver,

Turnbull and Meyberg represented an interest adverse to the trustee and the estate in the matter upon which they were to be engaged. This fact was well known to the receiver, but was not disclosed in his petition.

"Attached to and filed with the receiver's petition were the affidavits of Turnbull and Meyberg, each stating that he was 'not employed by or connected with the bankrupt or any other person having an interest adverse to the receiver, trustee or creditor.' The fact that Turnbull and Meyberg were attorneys for Heiser was not disclosed.

"The court below found that the receiver disclosed to the court that Turnbull and Meyberg were attorneys for Heiser, but the finding does not state when or how the disclosure was made. The evidence does not show that it was made at all. (Setting forth in Footnote No. 4, the following: 'It should here be noted that the judge who made the finding was not the judge who made the order authorizing the employment of Turnbull and Meyberg as attorneys for the receiver. The order was made by Judge James, the finding by Judge Cosgrave.') It certainly was not made at the time or in the manner required by General Order 44.

"The receiver's petition—written, filed and presented to the court by Turnbull and Meyberg—did not in terms state that it was necessary for the receiver to employ attorneys. It did, however, state that the receiver 'must have legal advice concerning his conduct'. This and other statements in the petition obviously were designed and intended to make it appear that it was necessary for the

receiver to employ attorneys. The record discloses no such necessity.

"*We conclude that the appointment of Turnbull and Meyberg as attorneys for the receiver was procured in violation of General Order 44, and that they are, therefore, not entitled to compensation.* Assuming, without deciding that, in some circumstances, a bankruptcy court may, in the exercise of its discretion, allow compensation to attorneys whose appointment was procured in violation of General Order 44, *we hold that, in the circumstances here shown, to allow such compensation was an abuse of discretion.*" (Emphasis added).

The dissenting opinion in *Woodruff* graphically points out how and wherein the facts of the instant case far more strongly call for disallowance than the facts involved in *Woodruff, e.g.:* (1) in *Woodruff* the attorneys were merely attorneys for what was, in substance, a mere ancillary receiver, who, as the dissenting Judge noted, was appointed "merely to conserve assets", and who had no duty to pass on the validity of claims; (2) in *Woodruff*, although the attorneys' representation of the creditor, Heiser, was not technically "disclosed" in their affidavits, nevertheless, it was abundantly apparent from various recorded documents, as noted by the dissenting Judge, as follows:

"The record is replete with evidence of the disclosure. It was on the petition of Heiser that the involuntary adjudication was made by the trial court, *and the attorneys Meyberg and Turnbull signed the petition as attorneys for Heiser.* Likewise it was this creditor who petitioned for the ap-

> pointment of the receiver, *and his petition is signed by these attorneys as counsel for Heiser.* The order of the court appointing the receiver recites that it was made *'upon motion of Rupert B. Turnbull, attorney for said petitioner'. Indeed, from first to last the record discloses on its face that these attorneys were counsel for Heiser, and the court could not but have been aware of that fact."* (Emphasis Added).

It is submitted that the following observations of the dissenting Judge render it clear that he would have supported disallowance on the facts of the instant case:

> "The spirit of the rule should be strictly enforced, but there is no justification for a purely mechanical application of it. Here, although the disclosure was not made in the precise manner required by the rule, there was an actual and complete disclosure of the facts. Ordinarily, it would be only in the petition itself that opportunity would be given to make the disclosure, but here the situation was different."

Manifestly, there was nothing in the record at the time of Appellant's employment to even remotely reflect his representation of "Amstan", nor to reflect the highly significant facts, known to Appellant prior to his employment, viz: (1) that "Amstan" held the personal guarantee of the principal of the Debtor; and (2) that there were "rumors" to the effect that the principal, Manildi, had caused assets of the Debtor to be diverted to Santa Monica, another corporation of which he was the dominating principal.

The majority opinion in the *Woodruff* case, insofar as it holds that "oral disclosure" is insufficient, is fully in accord with *In re H. L. Stratton, Inc.,* (2nd Cir., 1931) 51 F. 2d 984, which case, if anything, resulted in an even "harsher" decision. Thus, in the *Stratton* case the attorneys were surcharged for their entire fee of $15,000.00, over four (4) years after payment of same, based upon non-disclosure of a conflict of interest in their affidavit, notwithstanding that they had made an oral disclosure to the Judge, and, further, despite the fact that the Receiver's contention that a set-off was unlawful was ultimately held to be unmeritorious. With respect to the "harshness" of the decision, the court had the following to say:

> "However unfortunate the result may be to them (the attorneys), General Order No. 44 precludes appointment of counsel except upon order of the court founded on such an affidavit as is prescribed. It is not enough that they believed that the set-off was lawful and that an investigation finally bore out the correctness of their conclusion —.
>
> "Although everything indicates that the attorneys rendered valuable services to the estate of the bankrupt, we are constrained to hold that they are barred from receiving compensation as attorneys for the Receiver because of failure to comply with General Orders Nos. 42 and 44, and Local Rules Nos. 4 and 11, and that they must restore to the Trustee the $15,000.00, which they have been paid. *This is a drastic order, but the rules were made to be followed and require the results we have reached.*" (Emphasis Added).

In the *Woodruff* case, as well as in *Stratton,* the Trustee's objection to the claim of the creditor represented by the Receiver's attorneys was ultimately held to be unmeritorious. Hence, as previously noted, the fact that the Receiver's lawsuit in the instant case was ultimately settled by the Receiver's acceptance of funds from Santa Monica, as distinguished from the Manildis, is wholly irrelevant as a matter of law.

In *Earl Scheib, Inc. v. Superior Court,* (1967) 61 Cal. Rptr. 386, holding that the duty of an attorney to refrain from representing conflicting interests, continues *even after the termination of his employment by a former client,* the court stated the following at page 389:

> "An attorney has a constant and perpetual rendezvous with ethics. He stands as a trustee for his client's interests, a most sacred and confidential relationship. It is elementary that a conflict of interest between a trustee and his beneficiary is never permissible. As a trustee cannot maintain an attitude adverse to his beneficiary, so an attorney may not represent claims inconsistent with those of his clients, or conflicting claims of two clients. He cannot serve two masters."

This very case is an example of the reasons why the rules of ethics must be strictly enforced. Thus, as found by the Referee, Appellant must have known that a potential conflict very defintely existed, *ab initio.* However, he saw fit to take the "calculated risk", undoubtedly with the thought that when the conflict became so obviously apparent that it could not be ignored,

Appellant could then simply recommend that the Receiver employ "other counsel", and thereby gracefully bow out without any adverse consequences to himself. Clearly, the Supreme Court promulgated General Order No. 44 for the precise purpose of discouraging attorneys from taking precisely such "calculated risks" with all the potential evils attendant thereto.

Additionally, as pointed out by the Supreme Court in the *Woods* case, *supra,* it is almost impossible to determine the degree of damage resulting from a conflict of interest after the fact, and courts should not be required to assume such an onerous and inherently difficult burden.

VI.

Appellant's Dual Representation of "Amstan" and the Receiver, Clearly Involved a Conflict of Interest.

Appellant's belated contention that no conflict, in fact, existed need not overly detain us. Although Appellant's own testimony, and excerpts from his brief, previously quoted, clearly recognize that a conflict existed; nevertheless, we need not rely on Appellant's own "admissions". As noted in *In Re Westmoreland,* (D.C. Ga. 1967) 270 F. Supp. 408, at p. 411, the gist of a conflict within the meaning of Canon Six of the Canons of Professional Ethics of the American Bar Association, is as follows:

> "Within the meaning of this Canon, a lawyer represents conflicting interests when, in behalf of one client, it is his duty to contend for that which duty to another client requires him to oppose."

Applying the foregoing, simple test to the instant facts, Appellant's duty to "Amstan" was to acquire and preserve a prior attachment lien on real property of the Manildis, whereas Appellant's duty to the Receiver was to attempt to recover *any* property of the Manildis and, particularly, the self-same real property which, at one time, stood in the name of the Debtor, and which Manildi had caused to be transferred unto himself. A clearer case of conflict of interest is difficult to conceive.

Finally, with respect to Appellant's argument that Special Counsel was appointed *after* the fact of the conflict of interest was brought to the Receiver's attention, with the asserted result that Appellant did not represent the Receiver in connection with the matter involving the conflict, such simplistic and self-serving argument ignores the fact that Appellant was employed *from the beginning as General Counsel* for the Receiver, and that the conflict of interest existed in acute form *at least* from the date of his employment on June 6, 1963, to a date subsequent to August 19, 1963, when Special Counsel was employed. Furthermore, as noted by the Supreme Court in the *Woods* case, *supra,* it would be virtually impossible to speculate after the fact, as to what might have been accomplished by Appellant had he devoted his efforts loyally and vigorously on behalf of the Receiver, particularly in light of his unique information to the effect that Manildi had caused assets of the Debtor to be diverted to himself, and to Santa Monica.

VII.

The Decisions Relied Upon by Appellant Are All Factually Distinguishable.

Before proceeding to briefly analyze the factual distinctions between the facts of the instant case and certain of the decisions relied upon by Appellant, it should be conceded, in the interests of intellectual honesty, that at least one, or possibly two, of the decisions, while definitely distinguishable, are very possible contrary in philosophy to the provisions of General Order 44, the Supreme Court's decision in the *Woods* case, *supra,* and this Court's decision in the *Woodruff* case, *supra.* In so stating we have in mind, particularly, a case not cited by Appellant but which we feel compelled to bring to the Court's attention, namely, *Fine v. Weinberg,* (4th Cir., 1967) 384 F. 2d 471. This case is readily distinguishable in that it involves fees for an attorney for an assignee for the benefit of creditors which, of course, is not governed by General Order 44, but rather is governed by the same equitable principle under which fees are allowable to an assignee for the benefit of creditors, viz.: the equitable principle that services beneficial to a fund brought into a bankruptcy court should be compensated out of the fund. (Citing, *Randolph v. Scruggs,* (1903) 190 U.S. 533; *Flaxman v. Gardner,* (9th Cir., 1966) 353 F. 2d 764).

In *Fine v. Weinberg,* one Louis B. Fine, a member of the Norfolk law firm of Fine, Fine, Legum, Schwan & Fine, represented W. T. Byrns, Inc., as well as W. T. Byrns, individually. On June 11, 1965, he prepared an assignment for the benefit of creditors pursuant to which W. T. Byrns, Inc. assigned its assets to Andrew S. Fine, as assignee, the latter being a son of Louis B.

Fine, as well as a member of the same law firm. Thereafter, Andrew S. Fine, as assignee for the benefit of creditors, employed the services of his father as his attorney as assignee. Another attorney was retained to handle a special matter not material to the fee controversy. An assignee's sale was scheduled on June 24, 1965; however, one day prior thereto, several creditors filed an involuntary petition in bankruptcy against W. T. Byrns, Inc. The attorney for such creditors consented, in writing, to the assignee's sale provided the same be confirmed by the Bankruptcy Court. The sale was held and the sum of $25,840.53, constituted the proceeds. The Bankruptcy Court approved the sale on June 30, 1965. After adjudication the Trustee apparently discovered that W. T. Byrns, president and sole shareholder of the W. T. Byrns corporation had withdrawn the sum of $7,588.08 from the corporate bank account immediately prior to the execution of the assignment for the benefit of creditors, and the Bankruptcy Court thereafter entered an Order on April 27, 1966, directing W. T. Byrns to turn over to the Trustee in bankruptcy the aforesaid sum which he had withdrawn. The Bankruptcy Court found that there was insufficient time between the date of the assignment for the benefit of creditors and the date of the involuntary petition, within which Louis B. Fine could reasonably be expected to discover that Byrns had made the aforesaid withdrawal. The Court further found that when the conflict was discovered, Louis B. Fine and his firm withdrew as counsel for both the bankrupt corporation, as well as W. T. Byrns individually. The District Court in *In re W. T. Byrns, Inc.*, (D.C., Va. 1966) 260 F. Supp. 422, disallowed any fee to Louis B. Fine due to the conflict of interest even

though the fact of the conflict was unknown until *after* the services were rendered. The Fourth Circuit reversed the District Court apparently on the theory that "when the possibility of conflict grew into reality, he promptly withdrew his own, and his firm's representation of any conflicting interest".

While the foregoing case is readily distinguishable from the facts of the instant case, not only because General Order 44 is not involved, but, more significantly, because there, unlike the present case, the attorney had no knowledge of the conflict until *after* his services were completed, nevertheless, the case appears contrary in philosophy, if not in fact, to both the Supreme Court's decision in the *Woods* case, *supra,* and this Court's decision in the *Woodruff* case, *supra.* It further represents the type of equivocation based upon alleged "equitable considerations" which can only lead to the all too rapid erosion of the ethical principal prohibiting conflicts of interest.

In order to avoid unduly protracting this brief, the following are some of the factual distinctions between the instant case, and some of the cases cited by Appellant:

1. *Matter of Itemlab, Inc.,* (D.C., N.Y. 1966) 257 F. Supp. 764, is dinstinguishable as follows:

(a) The attorneys whose fees are involved were merely employed by the Trustee as Special Counsel and for a limited purpose only;

(b) Specifically, the attorneys were employed to invalidate a Chattel Mortgage, which they did, successfully. *After* the Chattel Mortgage had been invalidated, said attorneys' other client, (one, Dutch),

asserted a lien as to those assets covered by the invalidated Chattel Mortgage. Thus, as to the matter for which they were employed by the Trustee, the interests of the Trustee and said attorneys' other client, Dutch, were identical, insofar as seeking, and obtaining the Order invalidating the Chattel Mortgage, and the dispute arose after the services were rendered to the Trustee.

While the foregoing distinctions are significant, nevertheless, candor requires the concession that this case also is philosophically contrary to the decisions in *Woods* and *Woodruff, supra.*

2. *Matter of Cal-Neva Lodge, Inc.,* (D.C., Nev. 1967) set forth in Appendix A to Appellant's brief, is distinguishable as follows:

(a) There was, in fact, no conflict of interest as between the stockholder, Adler, and the corporate debtor in possession, inasmuch as Adler had subordinated all of his claims against the corporation to those of *all* other corporate creditors. Accordingly, the attorneys' representation of both the corporate debtor and the principal stockholder, Adler, did not result in any conflict of interest.

3. *Chicago & West Town's Railway v. Friedman,* (7th Cir., 1956) 230 F. 2d 364, is distinguishable as follows:

(a) This was a Chapter X corporate reorganization proceeding as to which General Order 44 is inapplicable since it is limited to attorneys representing Receivers, Trustess, or Debtors in Possession. Instead, the case was governed by §242 of the Bankruptcy Act (11 U.S.C. §642)

(b) Perhaps more importantly, no conflict existed at the inception of the case nor for a number of years thereafter. Approximately six years after the case was filed, during which time the attorneys involved represented the Creditors' Committee, said attorneys, on behalf of an outside client, submitted an offer to purchase the majority of the debtor corporation railway's common stock. The Court granted the attorneys the reasonable value of their services rendered up to the time that their client submitted their purchase offer.

In contrast, in the instance case, not only did the conflict actually exist from the inception of the case, but Appellant knew, or should have known, of its existence, as properly found by the Referee.

4. In *In re Philadelphia & W. Ry. Co.,* (D.C., Pa. 1947) 73 F. Supp. 169, the following are distinguishable facts:

(a) This, again, was a Chapter X corporate reorganization in which General Order 44 is inapplicable;

(b) Perhaps most significantly, there was, in fact, no conflict of interest, and the Court distinguished the case from the Supreme Court's decision in the *Woods* case, *supra,* on the basis that in *Woods* there was, from the very beginning, an existing conflict between the indenture trustee and the bondholder committee, both of whom were represented by the same counsel. In contrast, in the *Philadelphia* case no conflict, in fact, ever developed, and as the Court stated at page 173:

"There is nothing in the opinion in the *Wood case* to suggest that where no actual conflict of

> interest is shown to exist, the mere fact of representation of both indenture trustee and bondholder requires that compensation be denied."

Here again, in the instant case, as in the *Woods* case, an actual conflict in fact existed at all times from and after the inception of the proceeding, and, in addition thereto, the fact of the conflict was known by, or should have been known to, Appellant.

It is submitted, by way of final summation, that the facts of the instant case far more strongly require disallowance than do the facts of any of the other decisions cited by either party to this controversy, and that allowance of Appellant's fee, in the face of the facts of the case, would require overruling the *Woodruff* case, and the reduction of General Order 44 to a meaningless succession of hollow words.

Conclusion.

It is respectfully submitted that the respective Orders of the Referee and the District Court below be affirmed for all of the reasons hereinabove stated.

Respectfully submitted,

Joseph S. Potts,
Attorney for Appellee.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JOSEPH S. POTTS

EXHIBIT A.

Findings of Fact and Conclusions of Law.

United States District Court, Central District of California.

In the Matter of Haldeman Pipe & Supply Company, a California corporation, Debtor, No. 156,434-CC.

Filed June 15, 1967.

The present matter arises out of an Application for Compensation filed herein on or about May 6, 1966, by Haskell H. Grodberg, hereinafter referred to as "Grodberg", wherein said applicant prayed for an allowance of fees in the amount of $15,500.00, for services rendered by him as attorney for A. J. Bumb, receiver of the above-entitled estate. That on June 3, 1966, the undersigned Referee in Bankruptcy, to whom the proceeding had been duly referred, and before whom all matters had been conducted, noticed a hearing for June 9, 1966, for purposes of receiving further evidence with respect to the aforementioned application of Grodberg for compensation.

Subsequent to the hearing of June 9, 1966, and on or about August 1, 1966, the undersigned caused to be filed and served his proposed Findings of Fact, Conclusions of Law, and an Order with respect to Grodberg's Application for Compensation. Thereafter, and pursuant to a written request therefor filed on behalf of Grodberg, further hearings thereon were conducted on November 14, 1966, December 2, 1966, and December 8, 1966, at all of which said hearings Grodberg appeared by his attorneys, Beardsley, Hufstedler & Kemble, by Charles E. Beardsley, Seth M. Hufsted-

ler, and Stephen R. Farrand, and the receiver, A. J. Bumb, appearing by his Special Counsel, Joseph S. Potts, and evidence both oral and documentary having been introduced, and the court having taken the matter under submission, and having further considered proposed Findings of Fact and Conclusions of Law submitted by both counsel for Grodberg and the receiver, on behalf of their respective clients, and good cause appearing therefor, the court hereby makes the following:

FINDINGS OF FACT

1. That the above-entitled proceeding was commenced on May 31, 1963, by the debtor's filing of a Petition for an Arrangement under the provisions of §322 of the Bankruptcy Act (11 U.S.C. §722).

2. That prior thereto, and on May 24, 1963, a meeting of the debtor's larger creditors was held, which was attended, among others, by one William Collen, hereinafter referred to as "Collen," of Collen, Kessler & Kadison, attorneys with offices in Chicago, Illinois, representing Manufacturers' Clearing House, forwarders of certain claims of creditors of the debtor, including the claim of American Radiator & Standard Sanitary Corporation, hereinafter referred to as "Amstan," for purposes of brevity; that Amstan then had a claim against the debtor in the sum of approximately $120,000.00, of which $100,000.00 had been personally guaranteed by Jack Manildi and his wife, Vina Gale Manildi.

3. That Jack Manildi was president, a director, and, with his wife, the sole stockholder of the debtor, and he was also president, a director, and, with his wife,

the sole stockholder of a second corporation, Santa Monica Plumbing & Supply Company. That there had been extensive business and credit transactions between the debtor and the last-named corporation prior to the filing of the debtor's petition herein.

4. That on May 28, 1963, Grodberg was contacted by telephone from Chicago, by Collen, who advised Grodberg that the debtor was reported to be considering filing a Petition for an Arrangement under Chapter XI of the Bankruptcy Act, and Collen requested Grodberg to represent those creditors who were represented by Collen's law firm, and to contact the debtor's attorney, Leonard A. Goldman, hereinafter referred to as "Goldman," for further details. That Grodberg agreed to Collen's requests, and thereafter contacted Goldman relative to the debtor's situation and intentions.

5. That on May 31, 1963, Goldman filed the debtor's Petition under Chapter XI, and immediately thereafter on the same day, in the presence of Grodberg, requested the undersigned Referee in Bankruptcy, to whom the proceeding had just been referred, to appoint a Receiver. That on said date, A. J. Bumb was appointed receiver, qualified on the same day, and has ever since been, and still is, the duly appointed, qualified and acting receiver of the above-entitled debtor's estate.

6. That subsequently, on May 31, 1963, at the receiver's request, Grodberg prepared an Application, for the signature of the receiver, for an order authorizing the receiver to employ Grodberg as his attorney, as well as an Affidavit, signed and sworn to by Grodberg,

which Affidavit recites, among other things, the following:

> ". . .; that affiant represents certain unsecured creditors whose interests, so far as known to affiant, are identical to those of the receiver herein; that affiant does not represent any interest which is adverse to the receiver or to the creditors herein. . . ."

That the aforesaid Application, prepared by Grodberg for the receiver's signature, states, among other things, that Grodberg "is duly qualified and experienced in bankruptcy matters such as are involved in the administration of this estate." The order of employment, filed June 6, 1963, also prepared by Grodberg, recites that Grodberg was employed for the special and general purposes set out in the application of the receiver, which application, among other things, contains the following reasons or purposes for his employment:

> "E. To examine witnesses under the provisions of Section 21-A(sic) of the Bankruptcy Act as the same may be found necessary or appropriate to ascertain facts and to determine if legal action should be taken to preserve assets of this estate *including by way of specification and not by way of limitation the relationships between the above-entitled debtor and subsidiary or connected corporations with specific reference to business transactions between them.* (Emphasis added.)
>
> "F. To advise and assist applicant in the collection of accounts receivable and all other money, funds and property due and owing to the debtor as the same may be found necessary.

"G. To prepare on behalf of applicant necessary legal applications, answers, orders, reports and other papers.

"H. To confer with the Receiver rendering legal advice, and in general to render such other legal services as are usually rendered by attorneys for receivers in like proceedings."

7. Neither the affidavit nor the application makes any reference to the fact that Grodberg represented Amstan, or that Amstan was the holder of a guarantee from the Manildis to the extent of $100,000, or that Manildi was the president of the debtor, or that Manildi was a principal of Santa Monica Plumbing Supply Company, a debtor of Haldeman; or that Amstan (Collen) and Grodberg had discussed the matter of a suit against Manildi and of levies of attachment against his property. Each of these matters was known by Grodberg on June 4, 1963; and each of the matters, excepting possibly as to the guarantee, and the proposed suit and attachment were known on May 31, 1963, the date of the preparation by Grodberg of the application.

8. That subsequent to Grodberg's mailing to the receiver of the aforesaid Application for an order authorizing the receiver to employ Grodberg, and prior to June 6, 1963, the date on which the order was entered authorizing his employment as attorney for the receiver, Grodberg received a second telephone call from Collen in Chicago, on June 4, 1963, in the course of which Collen informed Grodberg that Amstan held personal guarantees of Mr. and Mrs. Manildi of the debtor's obligations to Amstan to the extent of $100,000.00,

and Collen further requested Grodberg to file an action thereon at the earliest possible moment and in connection therewith to promptly levy attachments on certain parcels of real property standing in the names of the Manildis, and Collen further explained to Grodberg that the urgency of an immediate attachment stemmed from the facts (1) that certain other creditors of the debtor also held personal guarantees of the Manildis, and (2) that one creditor, Alabama Pipe Company, had already attached parcels of real property owned by the Manildis.

9. That on the following day, June 5, 1963, Collen forwarded a letter to Grodberg transmitting copies of the Manildi's guarantees of the debtor's obligations to Amstan, in which letter Collen reiterated the urgency of a prompt suit and attachment. That Grodberg received Collen's said letter on or before June 8, 1963, on which date he drafted a complaint against the Manildis and prepared the documents necessary to effectuate an attachment on their real property. That the aforesaid complaint was filed on June 10, 1963, and the levies of attachment were made shortly thereafter.

10. That at least some of the real property upon which Grodberg caused attachments to be levied was subsequently sought to be recovered by the receiver in his Superior Court Action No. 825,741, referred to in greater detail hereinbelow.

11. That also on June 4, 1963, after his telephone conversation with Collen, referred to in Paragraph 8 hereinabove, Grodberg mentioned in the presence of Goldman and the receiver, following a meeting at the Bank of America, that one of the creditors he repre-

sented held a personal guaranty executed by the Manildis; however, Grodberg said nothing to indicate that the receiver had any cause of action, or possible cause of action, against Mr. or Mrs. Manildi, or Santa Monica Plumbing & Supply Co., and Grodberg likewise did not inform the receiver that he then intended to file a lawsuit on behalf of Amstan against the Manildis, based upon their guaranty, and also intended to attach certain real property standing in the names of the Manildis in connection therewith.

12. That shortly prior to July 26, 1963, Goldberg, acting as attorney for the receiver, prepared an Application, which was signed by the receiver on the last mentioned date, in which Application there was sought authority to employ an auditor, among other reasons, to investigate transfers of real property and other assets of the debtor to Manildi and to Santa Monica Plumbing & Supply Co. That on or about July 29, 1963, an Order was entered based on said Application, authorizing the receiver's employment of one Albert Kramer, hereinafter referred to as "Kramer", a Public Accountant, for purposes of conducting the examinations and auditing work referred to in the receiver's Application.

13. That on August 19, 1963, in the course of a conference attended by the receiver, Grodberg, Kramer, and Hubert F. Laugharn, hereinafter referred to as "Laugharn", attorney for the creditors' committee, Kramer orally reported that, in his opinion, there were possible causes of action in favor of the receiver against the Minildis and Santa Monica Plumbing & Supply Co., based upon allegedly improper transfers or diversions of assets and real property of the debtor to said

potential defendants. At this time, Grodberg notified the receiver *for the first time,* that, as attorney for Amstan, he had sued the Manildis and attached real property standing in their names, and Grodberg further suggested that the receiver should employ other counsel to handle any claims or litigation on behalf of the receiver as against the Manildis or Santa Monica Plumbing & Supply Co.

14. Thereafter, and on or about August 30, 1963, the receiver employed Laugharn as Special Counsel to prepare and prosecute various causes of action against the Manildis and Santa Monica Plumbing & Supply Co. That on September 23, 1963, Laugharn filed, on the receiver's behalf, Los Angeles Superior Court Action No. 825,741, against Jack Manildi, Vina Gale Manildi, and Santa Monica Plumbing & Supply Co. Ultimately, this litigation was settled and compromised, pursuant to which the sum of $32,000.00 was paid to the receiver out of the proceeds of sale of the assets of Santa Monica Plumbing & Supply Co.

15. That, although Grodberg obliquely mentioned that he represented a "guarantee" creditor during the course of one of several hearings in connection with the first meeting of creditors, the original of which was held on July 9, 1963, and although he further referred to the "Leland Trust" in favor of the "guarantee" creditors, in open court on September 3, 1963, nevertheless, he at no time made a direct statement to the court that he was representing an interest adverse to the receiver and the body of creditors generally, and the first time he suggested such possibility to the receiver was only after Kramer's oral report of August 19, 1963. That Grodberg never made, or even sug-

gested, any modification of his Affidavit, or the receiver's application.

16. That to avoid or minimize a "panic situation" affecting those creditors of the debtor holding personal guarantees of the Manildis, and to obviate a "race" as between them to first obtain attachment or execution liens on the Manildi's real property, negotiations were commenced in the latter part of June, 1963, between the several attorneys representing such "guarantee" creditors, including Grodberg, as attorney for Amstan, and Manildi and his personal attorney, William J. Tiernan. As a culmination of these negotiations there was created a guarantee creditors' trust, referred to as the "Leland Trust", pursuant to which it was provided that the "guarantee" creditors were to share proportionally to the extent of fifty per cent (50%) of their respective claims, without interest, in the proceedings of sale of the Manildi's real property, which had previously been attached by some or all of the "guarantee" creditors, and which said real property constituted the trust corpus. Said trust further provided that the "guarantee" creditors were further to receive an additional sum, not to exceed twenty-five per cent (25%), of their respective claims, in the form of dividends payable out of the debtor's estate herein, subject to the further proviso that any surplus over the aforementioned percentages, which might be received by the "guarantee" creditors, would be paid by them to the Manildis, who were also to be thereby released from any further liability under their guarantees.

17. That the provisions of the aforesaid "Leland Trust" were recognized and approved by the Order of September 27, 1963, confirming the debtor's plan of

arrangement. Said Order further reserved to the receiver all rights as against the Minildis and Santa Monica Plumbing & Supply Co. theretofore asserted in Los Angeles Superior Court Action No. 825,741.

18. That Grodberg received a total of $8,650.00 from Amstan for legal services rendered in connection with the suit he filed on its behalf against the Manildis, and the concommitant attachments of the latters' real property, and in participating on Amstan's behalf, in the negotiations culminating in the creation of the "Leland Trust".

19. That during the course of his representation of the receiver herein, Grodberg performed legal services, not involving matters relating to the Manildis, Santa Monica Plumbing & Supply Co., or other matters asserted in connection with Los Angeles Superior Court Action No. 825,741, for which he claims compensation in the amount of $15,500.00, the fair and reasonable value for which the Court finds is in the sum of $12,500.00.

20. That on May 31, 1963, at which time Grodberg prepared his Affidavit and the Application and Order authorizing his employment as attorney for the receiver herein, there was, in fact, an actual, if not yet known, conflict of interest as between the receiver, on the one hand, and Amstan, on the other hand.

21. That on or before June 6, 1963, the date of entry of the Order authorizing his employment as attorney for the receiver, Grodberg actually knew, or should have known, that his representation of the receiver then was, or would be, or, at least, might become, in substantial conflict with his representation of Amstan.

22. That Grodberg's representation of Amstan, in connection with which he sought to recover from the Manildis, was in substantial conflict with the receiver's possible rights to recovery from the Manildis.

23. That Amstan's levy of attachment on real property standing in the names of the Manildis reduced, and militated against, the receiver's ability to effect collection of any claim or cause of action he may have had against the Manildis.

24. That Grodberg's representation of Amstan rendered it improbable that he would advise the receiver that an involuntary petition in bankruptcy against the Manildis should be considered, and, if possible, filed, so as to avoid the various attachments levied by the "guarantee" creditors, including Amstan, on real property standing in the names of the Manildis.

25. That Grodberg's representation of Amstan further rendered it improbable that he would effectively advise the receiver in relation to any possible course of action which might conflict with, or impede, the prior and secured position of Amstan in relation to the Manildi real property, or otherwise.

From the foregoing Findings of Fact, the Court hereby makes the following:

CONCLUSIONS OF LAW

1. That on May 31, 1963, at which time Grodberg prepared his Affidavit and the Application and Order authorizing his employment as attorney for the receiver herein, there was, in fact, an actual, if not yet known, conflict of interest as between the receiver, on the one hand, and Amstan, on the other hand.

2. That on or before June 6, 1963, the date of entry of the Order authorizing his employment as attorney for the receiver, Grodberg actually knew, or should have known, that his representation of the receiver then was, or would be, or, at least, might become, in substantial conflict with his representation of Amstan.

3. That Grodberg's representation of Amstan, in connection with which he sought to recover from the Manildis, was in substantial conflict with the receiver's possible rights to recovery from the Manildis.

4. That Amstan's levy of attachment on real property standing in the names of the Manildis reduced, and militated against, the receiver's ability to effect collection of any claim or cause of action he may have had against the Manildis.

5. That Grodberg's original, and continuing, failure to set out in his Affidavit the facts respecting his representation of Amstan, its claims against the Manildis, and the relationships between the Manildis, Santa Monica Plumbing & Supply Co. and the debtor, constitutes a substantial violation of, and non-compliance with, the provisions of General Order 44 (11 U.S.C. following §53), which requires disallowance of any compensation to which he might otherwise be entitled as attorney for the receiver herein.

Dated: This 15 day of June, 1967.

/s/ RUSSELL B. SEYMOUR
Russell B. Seymour
Referee in Bankruptcy